UNIT 1

1.Meaning and Definition of Auditing

The word Audit is derived from Latin word "Audire" which means 'to hear'. Auditing is the verification of financial position as disclosed by the financial statements. It is an examination of accounts to ascertain whether the financial statements give a true and fair view financial position and profit or loss of the business. Auditing is the intelligent and critical test of accuracy, adequacy and dependability of accounting data and accounting statements. Different authors have defined auditing differently, some of the definition are:

"Auditing is an examination of accounting records undertaken with a view to establishment whether they correctly and completely reflect the transactions to which they purport to relate."-L.R.Dicksee

"Auditing is concerned with the verification of accounting data determining the accuracy and reliability of accounting statements and reports." - R.K. Mautz

"Auditing is the systematic examination of financial statements, records and related operations to determine adherence to generally accepted accounting principles, management policies and stated requirement." -R.E.Schlosser

2.Objectives of Auditing

The objectives of auditing are changing with the advancement of business techniques. Earlier it was only to check the correctness of receipts and payments. The objectives of the auditing have been classified under two heads:

1) Main objective

2) Subsidiary objectives

Main Objective: The main objective of the auditing is to find reliability of financial position and profit and loss statements. The objective is to ensure that the accounts reveal a true and fair view of the business and its transactions. The objective is to verify and establish that at a given date balance sheet presents true and fair view of financial position of the business and the profit and loss account gives the true and fair view of profit or loss for the accounting period. It is to be established that accounting statements satisfy certain degree of reliability. Thus the main objective of auditing is to form an independent judgement and opinion about the reliability of accounts and truth and fairness of financial state of affairs and working results.

Subsidiary objectives: The subsidiary objectives of the auditing are:

1. Detection and prevention of fraud: the one of the important subsidiary objective of auditing is the detection and prevention of fraud. Fraud refers to intentional misrepresentation of financial information. Fraud may involve:

a. Manipulation, falsification or alteration of records or documents

b. Misappropriation of assets.

c. Suppression of effect of transactions from records or documents.

d. Recording of transactions without substance.

e. Misapplication of accounting policies

2. Detection and prevention of errors: is another important objective of auditing. Auditing ensures that there is no mis-statement in the financial statements. Errors can be detected through checking and vouching thoroughly books of accounts, ledger accounts, vouchers and other relevant information.

3.Importance of Auditing

Importance of auditing can be judged from the fact that even those organizations which are not covered by companies Act get their financial statements audited. It has become a necessity for every commercial and even non- commercial organization. The importance of auditing can be summed in following points:

a. Audited accounts help a sole trader in knowing the value of the business for the purpose of sale.

b. Dispute over correctness of profits can be avoided.

c. Shareholders, who do not know about day-to-day administration of the company , can judge the performance of management from audited accounts.

d. It helps management in detecting and preventing errors and frauds.

e. Management gets advice on financial affairs from the auditors.

f. Long and short term creditors depend on audited financial statements while taking decision to grant credit to business houses.

g. Taxation authorities depend on audited statements in assessing the income tax, sales tax and wealth tax liability of the business.

h. Audited accounts are useful for the government while granting subsidies etc.

i. It can be used by insurance companies to settle the claims arising on account of loss by fire.

j. Audited accounts serve as a basis for calculating purchase consideration in case of amalgamation and absorption.

k. It safe guards the interests of the workers because audited accounts are useful for settling trade disputes for higher wages or bonus.

4. Types of audit

Based on ownership: On the basis of ownership audit can be:-

1. Audit of Proprietorship: In case of proprietary concerns, the owner himself takes the decision to get the accounts audited. Sole trader will decide about the scope of audit and appointment of auditor. The auditing work will depend upon the agreement of audit and the specific instructions given by the proprietor.

2. Audit of Partnership: To avoid any misunderstanding and doubt, partnership audits their accounts. Partnership deed on mutual agreement between the partners may provide for audit of financial statements. Auditor is appointed by the mutual consent of all the partners. Rights, duties and liabilities of auditor are defined in the mutual agreement and can be modified by the partners.

3. Audit of Companies: Under companies Act, audit of accounts of companies in India is compulsory. Chartered accountant who is professionally qualified is required for the audit of accounts of companies. Companies Act 1913 for the first time made it compulsory for joint stock companies to get their accounts audited from a qualified accountant. A number of amendments have been made in companies Act, 1956 and 2013 regarding appointment, duties, qualification, power and liabilities of a qualified auditor.

4. Audit of Trusts: The beneficiaries of the trusts may not have access and
knowledge of accounts of the trust. The trustees are appointed to manage and look after the property and business of the trust. Accounts of the trust are maintained as per the conditions and terms of the trust deed. The income of the trust is distributed to the beneficiaries. There are more chances of frauds and mis-appropriation of incomes. In the trust deed as well as in the Public Trust Act which provide for compulsory audit of the accounts of the trust by a qualified auditor. The audited accounts of the trust ensure true and fair view of accounts of the trust.

5. Audit of Accounts of Co-operative Societies: Co-Operative societies are established under the Co-Operative Societies Act, 1912. It contains various provisions for the regulations and the working of these societies. Some of the states have adopted it without any change, while others have brought certain changes to it. The auditor of the Co-operative Society should have an expert knowledge of the particular act under which Co-operative society under audit is functioning. He should also study by-laws of the society and make sure that the amendments made from time to time in the by-laws have been duly registered in the Registrar’s Office. Companies Act is not applicable to the co-operative Societies. The Registrar of co-operative societies shall audit or cause to be audited by some person authorized by him, the accounts of the society once in every financial year.

6. Government Audit: Audit of government offices and departments is covered under this heading. A separate department is maintained by government of India known as Accounts and Audit Department. This department is headed by the Comptroller and Auditor General of India. This department works only for the government offices and departments. This department cannot undertake audit of non-government concerns. Its working is strictly according to government rules and regulations.

Based on Time: On the basis of time the audit can be of following types:

1. Interim Audit: When an audit is conducted between two annual audits, such audit is known as Interim audit. It may involve complete checking of accounts for a part of the year. Sometimes it is conducted to enable the board of directors to declare an Interim dividend. It may also be for the purpose of dealing with interim figures of sales.

2. Continuous Audit: The Continuous Audit is conducted throughout the year or at the regular short intervals of time.

"A continuous audit involves a detailed examination of all the transactions by the auditor attending at regular intervals say weekly, fortnightly or monthly, during the whole period of trading." - T.R. Batliboi

"A continuous audit is one where the auditor or his staff is constantly engaged in checking the accounts during the whole period or where the auditor or hiss staff attends at regular or irregular intervals during the period." -R.C Williams

Advantages of continuous Audit:

a. Complete checking of all the records: Since the audit is carried out throughout the year, sufficient time is available for detailed checking. Any enquiry and doubt arising in the course of audit can be tackled in a better way.

b. Proper planning: Auditor can plan his audit work in a systematic manner. He can evenly spread his work throughout the year. It will improve efficiency of auditor.

c. Early detection of frauds and errors: The work of auditor becomes easier for detecting frauds and errors, otherwise it will involve more time.

d. Up-to-date accounts: The efficiency of account staff will increase and their work will be up-to-date and accurate.

e. Valuable suggestions: Continuous audit will help the auditor to understand the technicalities of business. This will help the auditor to make suggestions for the improvement of business.

f. Preparation of interim accounts: Interim accounts can be prepared without much delay. It will help the Board of Directors to declare interim dividend.

Disadvantages of Continuous Audit:

a. Expensive: It is an expensive system as it may not suit the budget of small organizations.

b. Dislocation of routine work: Frequent visits by auditor may dislocate the smooth flow of office work.

c. Alteration of Figures: after the accounts have been audited, the figures may be fraudulently altered by the staff.

d. Losing link in the audit work: As the work is not completed continuously, the auditor may lose continuity and certain questions and inquires may be left
unanswered.

3. Final Audit: Final Audit means when the audit work is conducted after the close of financial year. A final audit is commonly understood to be an audit which is not commenced until after end of the financial period and is then carried on until completed.

4. Balance Sheet Audit: Balance Sheet Audit relates to the verification of various items of balance sheet such as assets, liabilities, reserves and surplus, provisions and profit and loss balance. The procedure under this audit is to follow a backward process. First the item is located in balance sheet, and then it is located in original record for the purpose of verification.

Based on Objectives: On the basis of objectives the audit can be of following types:

1. Internal Audit: It implies the audit of accounts by the staff of the business. Internal audit is an appraisal activity within an organization for the review of the accounting, financial and other operations as basis for protective and constructive service to the management. It is a type of control which functions by measuring and evaluating the effectiveness of other types of control. It deals primarily with accounting and financial matters but it may also properly deal with matters of operating nature.

2. Cost Audit: Cost Audit is the verification of the correctness of cost accounts and adherence to the cost accounting plans. Cost Audit is the detailed checking of costing system, techniques and accounts to verifying correctness and to ensure adherence to the objectives of cost accounting.

3. Secretarial Audit: Secretarial Audit is concerned with verification compliance by the company of various provisions o Companies Act and other relevant laws. Secretarial audit report includes

a. Whether the books are maintained as per companies act, 2013.

b. Whether necessary approvals as required from central Government, Company law board or other authorities were obtained.

4. Independent Audit: Is conducted by the independent qualified auditor. The purpose of independent audit is to see whether financial statements give true and fair view of financial position and profits.

Mainly it is for safeguarding the interest of owners, shareholders and other parties who do not have knowledge of day-to-day operations of organization.

5. Tax Audit: Now-a-days tax audit has become very important to ascertain the accuracy of tax related documents. Tax audit mostly covers income returns, invoices, debit and credit notes and various current and fixed assets. Tax audit is an innovation of 21st century. It has added one more chapter to the practice of auditing. Tax audit ensures the validity and credibility of tax related documents.

UNIT II

Audit Programme

Meaning and Definition

Audit programme represents an outline of procedure to be followed to support an opinion on financial statements. It is the auditor's plan of action. It provides a plan of work of examination and a set of audit procedures.

According to Megis, An audit programme is a detailed plan of the auditing work to be performed, specifying the procedure to be followed in verification of each item in the financial statements and giving the estimated time required.

According to holmes, Audit programme is a flexible planned procedure of examination. Thus audit programme is a planning of audit by auditor so that he may be able to complete his work in a diligent manner and complete the work without loss of time.

Advantages of audit programme:

Some of the important advantages of thee audit programme are:

1. It enables the auditor to keep in touch with the work done and general progress of the work.
2. The auditor can be certain that the audit staff will cover whole of the ground.
3. It will help the audit assistants to know their duties.
4. It helps to increase the efficiency of audit assistants.
5. Fixing of the responsibility of audit assistants becomes easier.
6. It provides a check against the possibility of certain important items requiring verification which are being omitted.
7. Continuity is not lost even if the person on the duty is changed.

Audit Note book:

Audit note book is a diary or register maintained by audit staff to note errors, doubtful quarries and difficulties. The purpose is to note down the various points which need to be either clarified with the client or the chief editor.

The Audit note book is used for recording important points to be included in the auditor's report.

Contents of an Auditor's Note Book:

1. A list of books of accounts maintained.
2. The names, duties and responsibilities of principal officers.
3. The particulars of missing receipts and vouchers.
4. Mistakes and errors detected.
5. The points which need clarifications and explanations.
6. The points deserving the attention of the auditor.
7. Various totals and balances.
8. The Points to be a part of auditor's report.

Advantages of Audit Note book:

Some of the advantages of the audit note book are.
1. It ensures the uniformity and helps in knowing the amount of work performed.
2. Important matters relating to the audit work may be easily recalled.
3. Facilities and preparation of the audit report.
4. In case of the assistant in charge is changed, no difficulty is faced in continuing the incomplete work.
5. The responsibility of the errors undetected can be fixed on clerk concerned.
6. The audit note book shows the extent of the interest and pain taken by the audit staff. It helps in their appraisal.
7. It ensures that the audit programme has been sincerely followed. Deviations can be noticed.
8. It is reliable evidence in the court of law, If an auditor has to defend himself.

Audit working papers

Meaning and Definition

The term audit working papers designate the files of analysis, summaries, comments and correspondence built by an auditor during the course of the field work of an audit engagement. These papers contain essential facts about the accounts which are under audit.

According to Arnold W. Johnson, ‘’ Audit working papers are the written private materials, which an auditor prepares for each audit. They describe the accounting information which he receives from his client, the methods of examination used, the conclusions (and reasons thereof) and the financial statements.”

According to Jack C. Robertson, “Working papers are auditor’s own evidence of compliance with generally accepted auditing standards and of the decisions respecting all procedures necessary in the circumstances unique to the audit engagement.”

They consist of draft copies of trial balances, adjusting entries, accounts analysis, schedules of debtors and creditors summaries of reconciliation statements, certificates of official comments, copies of correspondence between auditors and debtors, creditors and bank, detailed schedule of items like depreciation, inventories previous audit reports, important quarries with explanation audit programme and other important materials.

Objectives of Audit working papers

The working paper serves following purposes:
1. They represent the volume of work performed by the auditor and his staff, which helps in preparing the report.
2. They show the extent of adherence to accounting principles and auditing standards.
3. They are useful as evidence against the charge of negligence.

4. They act as guide for subsequent examinations.
5. They enable the auditor to know the weakness of the internal check system in operation as also the accounting system.
6. They assist the auditor in coordinating and organizing the work of audit clerks.
7. They assist in planning and performance of audit work.

Internal Control

Meaning and Definition

Internal control is a broad term with a wide coverage. It covers the control of whole management system. Internal control involves a number of checks and controls exercised in a business to ensure its efficient and economic working.

According to The American Institute of Certified Public Accountants, "Internal control comprises of the plan of organization and all the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data to promote operational efficiency and to encourage adherence to prescribed managerial policies."

The system of internal control can be defined as, "the plan of organization and all the methods and procedures adopted by the management of an entity to assist in achieving the management's objectives of ensuring, as far as practicable, the orderly and efficient conduct of its business."

In brief it can be stated that internal control includes not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, to safeguard its assets and to secure as far as possible the accuracy and reliability of records.

Objectives/Need of the Internal Control:

1. Providing reliable data: Business decisions require accurate information o run the business efficiently. Examples of significant areas where management requires reliable information are fixation of selling prices production directives depending upon requirements etc. with the efficient internal control in place the accurate, required and reliable information can be provided for taking the important decisions and efficient performance of the activities.
2. To promote operational Efficiency: the controls within an organization are meant to prevent unnecessary duplication of efforts, protect against waste in all aspects of business and discourage other types of inefficient use of resources so as to promote the operational efficiency.
3. To encourage adherence to the prescribed policies: the system of internal control is meant to provide reasonable assurance that procedures and rules of various institutes are followed by company personnel.
4. Safeguarding assets and records: the physical assets of the company can be stolen, misused or accidently destroyed if not properly protected by adequate

controls. The internal control helps to safeguard the physical assets and to secure the accuracy and reliabilities of the records of the company.

Internal Check

Meaning and Definition:

Internal check is the valuable part of the internal control. It is an arrangement of the duties of members of staff in such a manner that the work performed one person is automatically and independently checked by the other.

According to F.R. M.e paula, "internal check means practically a continuous internal audit Carried on by the staff itself, by means of which the work of each individual is independently checked by other members of the staff."

According to D.R. Davar, " Internal check is a system or method introduced with defined instructions given to staff as to their sphere of work with a view to control and the verification of their work and also the maintenance of accurate records as the ultimate aim.

According To Joseph Lancaster, "The internal check is a method of organizing the entire operations, office, warehouse, factory and the duties to the respective staff so that frauds and irregularities are impossible without collusion."

All the definitions of internal check give a common idea about system organized within the concern itself, wherein the work of one employee is automatically checked up by the other and the possibility of error or fraud is reduced to the minimum.

Objectives of internal check:

1. To exercise moral pressure over the staff.
2. To ensure that the accounting system produces reliable and adequate information.
3. To provide protection to the resources of the business against fraud, carelessness and in efficiency.
4. To distribute work in such a manner that no business is left unrecorded.
5. To allocate duties and responsibilities of each clerk in such a way that he may held responsible for particular fraud or error.
6. To increase the efficiency of clerks because the allocation of duties is based on the principle of division of labour.
7. To detect errors and frauds easily if it is committed, because in an efficient internal check system, there is a provision for independent checking.

Advantages of Internal Check:

1. Proper division of work: internal check entails a proper and rational distribution of work among the members of staff of the enterprise keeping in view their individual qualifications, experience and area of specialization.
2. Detection of errors and frauds: since no individual worker is allowed to handle a job completely from the beginning to the end, and the work of each clerk is automatically checked by the other, this helps in the early detection and discovery of errors and frauds.

3. Increased efficiency coupled with economy: A good system of internal check increases the efficiency of work among the staff and leads to overall economy.
4. Convenience to auditor: where an organization is operating the system of internal check, the statutory auditor may conveniently avoid detailed checking of the transactions. He may apply a few tests here and there and can relieve himself from detailed checking.
5. Accuracy of the accounts can be relied upon: If there is a good system of internal check the owner of the concern may rely upon the genuineness and accuracy of the accounts.
6. Increase in Profits: overall efficiency and economy in operations result in more profits- thus ensuring larger dividends for the owners or shareholders.

Internal Check With Regard To Sales:

The system of internal check regarding sales should take care of following0:
1. On receipt of the order, it should numbered and preserved in Orders Received Book with full particulars.
2. The Despatch Department should be given a copy of the order with necessary particulars.
3. The Despatch Department should take steps to pack the goods as per order.
4. The statement of goods as prepared by the Despatch Department should be checked with the customer’s order and then invoice will be prepared in triplicate by means of carbon papers.
5. A responsible official should check the invoice particularly the rates charged and calculations made.
6. With the help of the copy of invoices entries should be made in Sales Day Book.
7. On dispatch of the goods records should be made in the Goods Outward Book.
8. Two copies of the invoice may be sent to customer who will return one of them after signing it. It will serve the purpose of delivery note. Third copy will be retained for further reference.
9. Entries should be made in Goods inward Book for all the goods returned by the customers. Credit notes should be prepared and should be duly checked and initialed by the responsible official.
10. With the help of credit notes, records should be made in the Sales Return Book.

Internal Check With Regard To Purchases:

1. Requisition: the procedure for issuing purchase requisitions should be specified. The head of the department, who is need of goods, should fill a requisition slip duly signed and then should send to the purchase department. The details about the quality, quantity and the time by which the goods must be supplied be clearly mentioned in the requisition slip.
2. Enquiry: Purchases department makes an enquiry about terms and conditions of the purchases from different suppliers for these purposes tenders are generally

invited. But, who shall open and accept the tenders, should be clearly specified. As rule lowest tender should be accepted and decision be taken.

3. Purchase Order: the purchase department places orders which should be recorded in the purchase order book. Four copies of purchase order should be prepared. One copy will be sent to vendor, the second to the store department, third to the accounting department and fourth will be retained by the purchase department itself. A responsible officer should review the purchase order, before signing by the authorized person or director.

4. Receipt of goods: on receipt of goods, the purchase department should properly inspect them, and after an entry in the goods inward (receipt) book, the same should be sent to the stores. Concerned department should be informed about the receipt of goods.

5. Making the payments: the purchase department should thoroughly check the invoices and send the same to accounting department for payment. The accounting department should compare the invoice with the purchase order and incoming inspection report and should verify the calculations. The accounts department should enter the invoice in purchase book. Only responsible official should draw cheque for the payment of invoice.

Internal check with regard to fixed assets:

1. A proper authority should be designated for the sanction of capital expenditure. The authority may be given to managing director, a factory manager or a committee may be set up for this purpose.
2. A proper authority should be designated even for sale of fixed assets, transfer or even for discarding of an asset.
3. Proper accounting records in respect of fixed assets should be maintained and it should be ensured that the proper accounting distinction is observed between capital and review expenditure.
4. There should be a periodic inspection of assets.
5. A fixed asset register must be maintained giving details of all the fixed assets. In this register description of the assets, their cost and location should be mentioned. Management should also ensure that all the fixed assets are verified physically from time to time.

Internal check with regard to cash transactions

CASH RECEIPTS:

1. There should be a separate clerk known as cashier to deal with the receipts of cash. Immediately upon receipts of cash a rough record of the amount should be made. The cashier should not be authorized to keep cash with him. He should not be

allowed to make expenditure out of it and to make entries in the ledger an d other books of prime entry.

2. All receipts should be banked daily. From time to time the bank reconciliation statements should be prepared to reconcile bank and cash balances.

3. Bank pay- in-slips should not be prepared by the same person who is incharge of making actual deposits in the bank.

4. All receipts should be acknowledged by means of printed receipts. Counter-foils of all the receipts issued should be properly maintained. Unused receipt must be kept with some responsible officer.

5. Spoiled receipts should be cancelled and not torn off. If some alterations is made in the receipts already written, it should be properly initialed.

CASH PAYMENTS:

1. The person in charge of making payments should have no connection with the receipts of cash.

2. All payments should, as far as possible be by chance cheques excluding petty cash payments. The cheques drawn for payment should be order cheques and as far as practicable they should be crossed.

3. Arrangements should be made to ensure that the vouchers supporting payments cannot be presented for the payments twice, such vouchers should be stamped as paid before the cheques are signed.

4. An official should check up the statements received from creditors and verify with the invoices and ledger accounts only after proper verifications cheques should be drawn in favour of the creditors.

5. For sanctioning the payments of special nature, only directors and senior officers should be empowered.

Unit III

Vouching and Audit of Financial Statements

Vouching

Meaning and Definition

Vouching is concerned with examining documentary evidence to ascertain the authenticity of entries in the books of accounts. In other words it is an inspection by the auditor of evidence supporting the transactions made in the books. Vouching is a technique used by an auditor to judge the truth of entries appearing in the books of accounts. Some important definitions of vouching are:

"Vouching means testing the truth of items appearing in the books of original entry." – J.R. Batliboi

"Vouching is an act of comparing entries in the books of accounts with documentary evidence in support thereof." - Dicksee

From the above definitions we can conclude that vouching is a technique in which an auditor verifies authenticity and authority of transactions recorded in the books and on the basis of which he submits a report, indicating that accounts are correct, free from errors or fraud and complete.

Objectives of Vouching:

1. All the transactions which are connected with the business have been recorded in the books of accounts properly.
2. To verify that all transactions recorded in the books of accounts are supported by documentary evidence.
3. The vouchers which support the entries are legally valid from the view point that they are authentic, addressed to the business and properly dated.
4. To verify that no fraud or error has been committed while recording the transaction in books of accounts.
5. The vouchers have been processed carefully through various stages of internal check system.
6. While recording the transaction whether distinction has been made between capital and revenue items.
7. Whether accuracy has been observed while totaling, carrying forward and recording an amount in the account.

Vouching of cash Transactions:

How to vouch various cash receipts (Receipt side)

1. Cash sales: In vouching cash sales, cash register should be fully checked with carbon copies of cash memos. Then, the auditor should verify the daily deposits of cash received in the bank dates of the cash and the date on which the receipts are recorded in cash book must be same.

Where the cash memos are cancelled, all copies including the original copy duly cancelled should be kept in the book. Where a company has a discount policy, if more discount is allowed in a transaction it must be approved by a responsible officer.

2. Cash received from the debtors: The auditor should verify amount received from debtors from the counterfoils or carbon copies of the receipt issued to the customers. All these receipts should be serially numbered. Amount should be entered in the cash book on the day when received. Discount allowed to customers should be authorized by a responsible officer. Sometimes correspondence made with customer can also be verified.

3. Loans: While vouching the loans received, the terms and the conditions contained in the agreement should be verified. If the loan is secured what security has been offered, whether the fact has been disclosed in the balance sheet.

4. Bills receivable: Bills receivable book maybe verified because the various details regarding the bills matured and discounted are available in it. Auditor should check the amount received with the bank statement. Some bills might have become due but no amount has been received. Whether the entry for the dishonor of such bill has been made. A verification of the bills discounted should be made. Whether, entry for discount has been made. Such bills should appear as contingent liability in the balance sheet; if the date of maturity is after the date of balance sheet.

Vouching of cash payments (payment side):

1. Cash Purchases: good purchased are actually received by store keeper. Cash memos can be compared with goods inward book to verify the goods received. Only the net amount (after trade discount) should be entered in the books.

2. Payment to creditors: Should be examined with the receipts issued by the creditors. The receipts should indicate the purpose for which the payment has been made. If the payment is made in full and final settlement of account, the balance should be accounted for as discount received. Where the payment is made in excess of the bill, either the excess payment is in advance or the payment is made by mistake, which should be recovered back from the creditor.

3. Bills payable: Bills payable honored on the date of maturity and is returned by the payee after receiving the payment. These bills should be cancelled after being paid. Bills payable paid can be vouched with bills book. If the payment is made by the bank, bank statement or pass book can be examined to verify the payment of bill

4. Wages: wages paid and calculated for various months should be compared. If the wages of particular month differ from the preceding month, the auditor should look into the reasons for difference. Random checking of wages calculations should be made. The auditor should see the proper record is maintained for unpaid wages, deductions for any advance taken by the worker should also be verified, and

deductions made from the wages should also be entered in the proper account. Special attention should be given to the payments made to casual workers.
5. Payment Of Salaries: in vouching the payment of salaries following points are important
a. Auditor should check salary register with the entries made in the cash book
b. He should examine carefully alterations in the amount of deductions on account of fines, funds, loans, insurance etc.

Vouching of Trading Transactions

Vouching of purchase book:

The main aim vouching of purchases book is to see that all purchase invoices are entered in purchases book and the goods entered in the purchases book are entered are actually received by the business.

While vouching credit purchases the auditor should examine and see the following points.

i. There should be proper record for all purchase orders. A duplicate copy of the order is kept in office for record.
ii. A copy of purchase order shall be send to the Accounts Department.
iii. All goods received should be recorded on goods received note; a copy of it should be sent to Accounts Department.

1. The auditor should see that only credit purchases of the goods are recorded in purchase book.
2. The purchases book can be verified from purchase invoices, copies of orders placed, goods received note, goods inward book, copies of challans from suppliers.
3. The quantity mentioned in the invoice must be same as is shown in the purchase order.
4. The price charged by the supplier must be as per quotation/pricelist of the supplier.
5. The supplier bill must be in the name of business and for the period under audit.
6. While vouching the purchase vouchers, each voucher should be stamped or initialed after examination, so that it could not be produced again.
7. Any purchase, made not for the purpose of business of the client, must not be debited to purchase account.

Vouching of Purchase Returns

While vouching the purchase returns the following points should be taken into consideration by the auditor.

1. He should see that a Debit note has been sent to the supplier or Credit note has been received from the supplier.
2. The quantity returned as per the return note must correspond with storekeeper's record, return outward register and gatekeeper's outward register.
3. The amount showed in the credit note should be verified.
4. He should be careful about the recordings of purchases return in the current year. Sometimes the profits of current year may be manipulated by recording current year's purchases return in the subsequent year.
5. The purchases return of the first month and last month of the Accounting year should be vouched carefully, to detect any manipulation of amounts.

Vouching of Credit Sales

1. The sales register should be examined with copies of sales invoices. The sale of capital items should not be recorded in the sales book, otherwise the profits will be inflated.
2. Test check should be applied on the calculations made in sale invoices.
3. The totaling and the castings of sales book should be verified.
4. Sales Tax, duties collected thorough sales invoices must be recorded under separate accounts.
5. It should be verified that all sales invoices are prepared on the basis of challans and then sales invoices are entered in sales book and from there, posted to their respected accounts.
6. Sales made in the current year must be recorded under that year and shall not be treated as sales of subsequent year.

Vouching of Sales Return

The Auditor should pay special attention to the following while vouching the sales return

1. Date on which the goods are actually retuned.
2. Credit note or Debit note of sales return.
3. Gatekeeper's receipt book.
4. Return inward register.
5. Stores records.
6. Corresponding entry for the return of goods in customer's account.
7. Goods returned should form the part of closing stock at cost price or market price whichever is less.

Management and Tax Audit

MANAGEMENT AUDIT

Meaning and Definition

Management audit is attempt made to evaluate various management functions and process. A detailed and critical review of all the objectives, policies, procedures and functions of management is made with a view to bring about an overall improvement in managerial efficiency.

According to Leslie R. Howard, " An investigation of a business from the highest level downward in order to ascertain whether sound management prevails throughout, thus facilitating the most effective relationship with outside world and the most efficient organization and smooth running of internal organization."

According to W.P. Leonard, "A comprehensive and constructive examination of an organization structure of a company, institution or a branch of government or of any component thereof such as division or department, and its plans and objectives, its means of operations, and its uses of human and physical facilities."

Thus it can be simply stated that management audit, on the basis of established standards, examines, reviews and appraises the various policies and actions of management.

Objectives/Aims of management Audit

1. To ensure that sound objectives are set by the management.
2. To reveal any irregularity or defect in the process of management and to suggest improvements to obtain the best results.
3. To ensure that the management objectives are achieved.
4. To help various levels of management in the effective discharge of their duties.
5. To assist management in achieving coordination among various departments.
6. To help to achieve the efficiency of management.
7. To assist management in establishing good relations with the employees and to elaborate duties, rights and liabilities of entire staff.
8. To evaluate the performance by comparing inputs with outputs (human and physical both).
9. To ensure most effective relationship with the outsiders and the most efficient internal organization.
10. To recommend changes in the policies and procedure for a better future.

Advantages of Management Audit

1. It helps management in preparation of plans, objectives and policies and their efficient achievement.
2. It helps management in taking vital decisions for maximization of profits.
3. It helps the management in strengthening its communication systems within and outside the business.
4. It helps in evaluating the performance of management in various areas and measures to improve it.

5. It can help management in preparation of budgets and resource management.
6. It can help management in training of personnel and marketing policies.

Need/importance of Management Audit:

The statutory auditor is not required to examine the policies of management and their implementation or whether any improvement in the efficiency of management can be made. In these days a report on all these matters is very important to the business. The management auditors are appointed to advise the management on various matters related to management. These persons
examine the various aspects of management and evaluate the actual performance by comparing it with predetermined standards. Such auditors may or may not be from the field of accountancy. They advise management on the matters relating to performance of various departments as well as of the
organization as a whole.

The management may conduct management audit periodically to review the efficiency of managers. The results may be used to provide incentives to staff.

The management audit reveals irregularities and defects in the working of management and suggests the ways to improve the efficiency of management. It concentrates on the results and does not examine whether procedures have been followed or not. The government may ask for management audit of sick industrial units with a view to examine the efficiency of management. It may be conducted to find whether the sickness is due to functioning of management or the circumstances beyond the control of management.

Appointment of Management Auditor

A team of experts should be appointed to conducted management audit. It can't be expected that an individual can possess expertise in all management's fields; therefore, an expert in each field of management should be included in the team of management auditors. Such team should have full cooperation from the top level management to enable it to conduct the audit smoothly.

The members of management audit team should have a proper training and expert knowledge of science of management. A wide experience of actual work situations will be added to the advantage. The audit of the management involves an appraisal of activities of organization; the auditor must study the organization and its plan in detail. The internal auditors may be regarded as suitable persons for conduct of management audit because they are familiar with the internal workings of management. Sometimes it is desirable to have O & M experts as management auditors. All will depend on the scope of management audit which the management has to decide.

Qualities of a Management Auditor

The area of activities of management audit is wide; no specific qualities can be narrated for management auditor. He must possess enough qualities to fulfill his professional obligations. Some of the qualities of the management auditor can be described as follows.

1. He should have a good knowledge of managerial functions.
2. He should be familiar with the various principles of management, planning, control,management by objectives, and management by exception.
3. He should have a good understanding of financial statements and their preparations.
4. He should understand the working of organization and its problems.
5. He should be able to understand the objectives of organization.
6. He should be able to assess and critically examine the internal control systems.
7. He should be able to understand the nature of the product and its production process.
8. He should understand plans, budgets, rules and the procedures applied in the organization.
9. He should have a good knowledge of financial statement analysis techniques like standard costing, budgetary control, ratio analysis, fund flow statements etc.
10. He should be familiar with the human resources accounting, social accounting, etc.

Management Auditor’s Report

In the end, the management auditor prepares a report. On the basis of findings and definite information, the auditor prepares a report making suggestions for improvement in the working of the management. His report should give a correct assessment of the working of organization. He should not hesitate in criticizing the management. His recommendations should be constructive and not merely condemning in nature. His report may include the following matters:

1. Whether the management; and the staff relations are healthy.
2. Whether the return to shareholders is adequate.
3. Whether the methods of production are out-dated.
4. Comparison of operating efficiency of the organization with other concerns.
5. Rate of the return on investment.

Conduct of Management Audit

Following points need careful attention before he commences his work.

1. The auditor should ensure that various objectives and goals are properly established which are likely to help to achieve the desired results.
2. He should see that the plan laid down by management is practicable and helpful to achieve objectives.
3. He should see that whether the organization has a well defined structure, authority lines and responsibility areas are clear, decision making is centralized or decentralized.
4. He should verify the efficiency of information system operating in the organization.

6. The information obtained with the help of above questions should be counter checked from the various records and statements available in the organization.
7. To arrive at definite conclusions, the management audit has to correlate the information collected through various means.

Tax Audit

Introduction

Now-a-days tax audit has become very important to ascertain the accuracy of tax related documents. Tax audit mostly covers income returns, invoices, debt and credit notes and various current and fixed assets. Tax audit is an innovation of 21st century. It has added one more chapter to the procedure of auditing. Tax audit ensures the validity and credibility of tax related documents. The financial statements are certified by the auditor for truth and fairness of operating results and financial position of the business. These are meant for general purpose being used by the owners, creditors, banks and other interested parties. Sometimes a specific information my required by certain people which may not be available in these statements

Under Income Tax Act, profits shown by profit and loss A/c have to be adjusted as per the provisions of the Act. In this way profits for accounting and profits for taxation are not the same. These profits differ due to various reasons. Profits for accounting are ascertained As per accounting policies and standards but profits for the tax purpose are computes as per the provisions and rules of Income Tax Act.

The Income Tax Department cannot verify each and every detail of provisions compiled by the assessee. In this regard expertise of auditors is utilized, who certify the compliance of the provisions of Income Tax Act.

How to conduct tax Audit

1. The tax auditor shall be guided by the auditing standards and guidance notes as issued from time to time by Institute of Chartered Accountants of India.
2. Obtaining books of accounts, financial statements and other statements of particulars duly authenticated.
3. Evaluation of internal control system on the basis of which extent of vouching and verification can be determined.
4. While conducting tax audit the provisions and objectives of sec, 44 AB shall be kept in mind.
5. The auditor shall have thorough knowledge of taxation provisions and judicial pronouncements.
6. The Central Government has notified the following 'accounting Standards' in respect of audit of financial statements under section 44 AB.

Compulsory Tax Audit

Following are provisions relating to compulsory audit under Section 44(AB) of income Tax Act.

I. Tax audit is compulsory for a business if its total sales, turnover or gross receipts in a previous year exceed Rs 1 crore.
II. In case of a profession, Tax audit is compulsory if gross receipt exceed Rs. 25 lakhs.
III. If the profits of a business are determined on presumptive basis, the audit of accounts shall be on compulsory basis if he assessee claims that their profits are less then profits computed under the following sections

A. Sec 44 (AD) -profit from any business (whether it is retail trading or civil construction or any other business)

Provisions are as follows

a. Assessee should be resident individual or resident HUF or resident partnership
b. Assessee has not claimed exemption under section 10 (A), 10 (AA), 10 (B), 10 (BA), 80 (HH) or 80 (RRB)

The following persons are not eligible

a. Person carrying on profession under [section 44 (AA) (1)]
b. The person earning commission or brokerage or carrying on agency business or plying, hiring or leasing goods carriage.
c. Turnover/gross receipt in the previous year should not exceed 1 crore

B. Profit from the business of carriage of goods [section 44 (AE)]

This sec is applicable to only those persons who are engaged in plying, hiring or leasing goods carriages and own not more than 10 such goods carriages.

C. Profit and gains of a non resident from shipping business [sec. 44 (B)]

A sum equal to 7.5% of the aggregate receipts in India shall be deemed to be the profit. If the assessee does not opt for the above scheme he will have to get accounts audited.

D. Profit and gain of business of Oil exploration of non-resident assessee [sec. 44 (BB)]

A sum equal to 10% of amount payable in India or outside India to assessee shall be deemed to the profit If the assessee does not opt for the above scheme he will have to get accounts audited.

E. Profit and gains of business of operation of Aircraft by Non- resident[sec. 44

A sum equal to 5% of amount payable in India or outside India to assessee shall be deemed to the profit . If the assessee does not opt for the above scheme he will have to get accounts audited.

F. Profit Of Foreign Company Engaged in Business of civil Construction or Erection of plant and machinery or/and Commission thereof[sec. 44 (BBB)]

A sum equal to 10% of amount payable in India or outside India to assessee shall be deemed to the profit . If the assessee does not opt for the above scheme he will have to get accounts audited.

Meaning of Business

Business simply means any economic activity carried on for earning profits. Section2 (3) of Income Tax Act 1961, has defined term Business as, “Any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce and manufacture.” In the words of Justice S.R. Das, “The Word ‘Business’ connotes some real, substantive and systematic or organized course, activity or conducted with a set purpose.”

In This connection it is not necessary that there should be a series of transactions in business and also it should be carried on permanently. Neither repetition nor continuity of similar transactions necessary.

Meaning of Profession

A Profession is an occupation requiring purely intellectual skill or manual skill controlled by the intellectual skill of operator e.g. Lawyer, Accountant, Engineer, Surgeon etc. So profession refers to those activities where livelihood by the persons through their intellectual or manual skill.

Under section 2 (6) profession includes vocation.

Vocation simply means any type of activity in which a person is engaged and he earns livelihood from such activity.

Unit 5

Audit of Institutions

Audit of Accounts of partnership Firms

To avoid any misunderstanding and doubt, partnership firms recognize the advantage of audit of financial statements. Partnership deed on mutual agreement between the partners may provide for audit of financial statements. Auditor is appointed by the mutual consent of all the partners. Rights,
duties and liabilities of the auditor are defined in the mutual agreement and can be modified by partners. It will be in the interest of the auditor to get in writing the nature and scope of his work to avoid any dispute later on.

While conducting the audit of partnership firm the auditor must refer to the deed or Partnership Act 1932.

It is not legally compulsory to get accounts of partnership audited. The possibilities of mistrust and dissatisfaction are greater incase of partnership. An independent Auditor's view on the correctness of accounts is desirable in case of partnership concerns. Usually the partnership deed provides for the
audit of accounts.

When partnership is silent, the following provisions of Partnership Act, 1932 will apply and auditor will take care of following points:

1. All partners will share profit or loss equally.
2. None of the partners will be entitled to receive any salary or remuneration.
3. Interest payable to partner on his capital, if any, shall be payable out of profits.
4. A partner contributing moneys in excess of agreed amount of capital will get interest at
the rate of 6% p.a1
5. The partners shall use the property of the firm exclusively for the purposes of business.

Advantages of audit of partnership firms:

1. It helps in detection and prevention of frauds or frauds or errors, and verification of correctness of accounts.
2. Any dispute between the partners relating to accounts can be settled by presenting independently audited accounts.
3. The periodical visits and suggestions by the auditor may prove to be helpful in improvement of management of the firm.
4. In case of admission, retirement or death of a partner, audited accounts are acceptable to all to adjust the accounts between the partners.
5. The audited accounts are helpful for income-tax assessment or for borrowing from the banks.

Company Audit

A company is said to be an artificial person created by law having a separate legal entity distinct from its members. It cannot be directly managed by its owners because they are very large in number have small holding and also scattered over a wide area. As such the management and control of the affairs of the company is done by directors but an absolute faith put in directors is not considered to be desirable on social and moral grounds. Hence, it becomes essential for a company to appoint an independent and qualified person i.e. an auditor, to verify and certify the truth and fairness of the financial statements.

Further, the companies usually work with a large staff and auditing serves a very useful purpose of locating all errors and irregularities in their work.

In order to achieve the above objectives, The Indian Companies Act 1956 has made it a statutory obligations for joint staff companies, whether public or private, to get their accounts audited by qualified auditor.

Statutory requirements governing the Company Auditors

Before commencing the audit work of company, the auditor should go through the following

1. Ensuring Whether his appointment is in order: Before commencing the audit work of a company the auditor shall ensure that all legal provisions relating to his appointment have been duly compiled with to ensure is appoint is in order. If his appointment is made in general meeting of the company, he should obtain the resolution of his appointment passed in such meeting. In case he has appointed in place of retiring auditor, he shall find out a due notice has been given to the retiring auditor in this regard. In case if the casual vacancy is due to resignation of the auditor, he shall obtain the copy of the resolution passed at general meeting making his appointment. He shall ensure that his remuneration has been fixed by the company as per the provisions of the Act.

2. Inspection of Statutory Books and Documents: Before the auditor commences the work of audit, he should examine the following documents

a. Memorandum of Association.
b. Articles of Association.
c. Prospectus.
d. Certificate of in cooperation and certificate to commence business

He should also examine the following statutory books and registers.

a. Register of Members. (Sec 88)
b. Index of Members. (Sec 88)
c. Register and Index of Debenture holders. (Sec 88)
d. Register to Mortgages and charges (Sec 85)
e. Register of Investment [sec 187(3)]
f. Foreign Register (Sec 88)
g. Register of Contracts (Sec 188, 184 and 189)

h. Register of Directors, managing Director , Manager and Secretary (170)
i. Register of Director's Shareholdings (170)
j. Register of Deposits (73)
k. Register of Loans (Sec [186(9)]
l. Minute books (118)

3. Inspection of Contracts: The auditor should inspect and examine the contracts which have been entered into by a company with other e.g.

a. Contracts with the vendors of any property.
b. Contracts with brokers and under writers for their commission.
c. Contract with the promoters for the preliminary expenses, etc.

If any statement regarding these contracts has been made by the company in the prospectus, the auditor should see that such statement is correct and that entries relating to such contracts are correctly recorded in the books of account.

4. Study of Previous year's balance Sheet and Auditor's report: the auditor should inspect the previous year's balance sheet to verify the opening balances of the current year. Moreover, according to Companies Act, the corresponding figures of the previous year have to be given in the balance sheet.

The last audit report is inspected by the auditor mainly for two purposes.

a. To formulate a rough idea about the company and its working.
b. To see whether the recommendations made there in have been carried out or not.

Audit Report /Auditor's Report

An auditor's Report is the format of result of all the effort that goes into the audit. Communicating the Auditor's findings to interested users is part of all audits. Thus, the Final phase of an Audit involves preparing that communication, which is known as auditor's report.

According to Lancaster, "Audit report is statement of collected and considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of full facts of subject matter of the report."

It presents the results of the examination done by the auditor. An audit involves collection of evidence about the financial statements. The evidence collected needs to be carefully shifted and analyzed to enable the auditor to draw appropriate conclusions. The conclusions drawn are communicated to

Contents of Audit Report

Under section 227 (2) every auditor is required to make report to the shareholders on the accountants examined by him and every balance sheet and profit and loss A/c and every document declared by law to be part of or annexed to the balance sheet and profit or loss A/C which are placed before the shareholders of the company at the general meeting during tenure of his office. The report has to state whether, in his opinion and to the best of his information and according to the explanations

given to him, the said accountants give the information required by the Companies Act in manner so
required and give a true and fair view.
i. In the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and
ii. In the case of profit and loss account, of the profit or loss account for its financial year.
a. Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit;
b. Whether in his opinion, proper books of account as required by law have been kept by the company so far as appears from hiss examination of these books, and proper returns adequate for the purposes of his audits have been received from the branches not visited by him .
c. Whether the report on the accounts of any branch office audited under section 228 by a person other than the company's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.
d. Whether the company's balance sheet and profit and loss A/C dealt with by the report are in agreement with the books of accounts and returns.
Preparation/Matters to be included in the Audit Report
1. Fixed Assets:
The auditor's report shall include statements on the following matters:
a. Whether the company is maintaining the proper records showing particulars, including quantitative details and situations of fixed assets.
b. Whether these assets have been physically verified by the management at reasonable intervals, whether any material discrepancies were noticed on such verification, and if so whether the same have been properly dealt within the books of accounts.
c. If a substantial part of fixed assets has been disposed off during the year, Whether it has affected the going concern.
2. Inventories:
The auditor has to make the following three specific statements on verification and valuation of inventories:
a. Whether the physical verification of inventory has been conducted at reasonable intervals by the management.
b. Are the procedures of physical verification of inventories followed by management reasonable and adequate in relation to the size of the company and the nature of its business? If not the inadequacies in such procedures should be reported.
c. Whether the company is maintaining proper records of inventory and whether any material discrepancies have been noticed on physical verification and if so, whether the same have been properly dealt in within the books of account.
3. Loans taken from/granted to parties covered under section 189:

The auditor ha to made four specific statements as under

Has the company either granted or taken any loan, secured or unsecured to/from companies, firms or other parties covered in the register maintained under section 189 of the Act. If so give the number of parties and amount involved in the transactions.

a. Whether rate of interest and other terms and conditions of loans given or taken by the company, secured or unsecured are primafacie prejudicial to the interest of the company

b. Whether the payment of principal amount and interest are also irregular

c. If overdue amount is more than 1 lakh, whether reasonable steps has been taken by the company for recovery/payment of principal and interest.

4. Internal control on purchase of assets and sale of goods:

The auditor has to commit on the following:

Is there an adequate internal control procedure commensurate with the size of the company and the nature of its business for the purchase of inventory and fixed assets and for the sale of goods?

Whether there is continuing failure to correct major weaknesses in internal control.

5. Maintenance of Cost Record:

Whether the maintenance of cost records has been prescribed by the central government u/s 128 of the Act, Whether such accounts and records have been made and maintained.

6. Indication of sickness:

Whether in case of a company which has been register for a period not less than five years, its accumulated losses at the end of the financial year for not less than 50% of its net worth and whether it has incurred cash losses in such financial year immediately preceding in such financial year also.

7. Documents and records for Secured loans:

Whether adequate documents and records are maintained in case where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities? If not, the deficiency to be pointed out.

8. Guarantees for loans taken by other:

Whether the company has given any guarantee for loans taken by others from bank or financial institutions, the Terms and conditions whereof are prejudicial to the interest of the company.

9. Disclosure of end use of money raised from public issue:

Whether the management has disclosed on the end use of money raised by public issue and the same has been verified.

10. Fraud:

Whether the fraud on or by the company has been noticed or reported during the year if yes the nature and the amount involved to be indicated.

Unqualified/ Clean/ Fair report:

When an auditor is satisfied with the fairness of the balance sheet and profit and loss account he will give a clean report. The auditor makes various statutory affirmations without reservations He is said to have the given an unqualified report on financial statements of the company.

Even when an auditor has given a clean report, it does not mean that it is absolutely accurate in other words the auditor is not guarantor of insurer as is observed by Lord Justice lopes in re. Kingston cotton mills co. Ltd. Case, "auditor must not be held liable for not tracing out ingenious and carefully laid schemes or fraud, when there is nothing to arose their suspicion."

Qualified Report:

If the auditor is of the opinion that the balance sheet does not give the true and the fair view of the state of company's affairs or, that profit and loss account does not give true and fair view of the profit or loss for the year he must qualify his report accordingly. When an auditor concludes on the basis of sufficient appropriate audit evidence that mis-statements are material but not pervaise to the financial statements or he is unable to obtain sufficient or appropriate evidence to conclude that financial statements are free from material mis-statements, such mis-statements remaining undetected may be material but not pervaise.